GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, MARCH 21, 2023

- **Low liquidity and crowded positioning seen as amplifying recent Treasury yield moves** (link)
- **US government bond funds see strong inflows amid flight-to-quality shift** (link)
- **ECB and BoE reassuring AT1 bond seniority to equity eases capital structure angst** (link)
- **ECB officials stress importance of implementing Basel III regulations** (link)
- **Overnight funding costs show signs of cash squeeze in China and Hong Kong SAR** (link)
- **Index of African sovereign spreads move above 1000 bp distressed debt threshold** (link)

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Risk assets rebound as global banking concerns ease

Global risk assets have staged a relief rally over the last day as investors are exhibiting less tension around US and European banking sectors and anticipation builds for major central bank policy decisions later this week. US and European equities reversed early day losses yesterday with most major indices closing in positive territory. Following the takeover of Credit Suisse by UBS and reassuring comments from global central bank leaders and policymakers to start the week, investor concerns over the global banking system have eased slightly, helping to boost risk sentiment, especially towards regional banks. US Treasury yields have turned higher across the curve, particularly for near-dated maturities with 2-year yields once again above 4.1%. The risk-on momentum has continued overnight and this morning with Asian and European bourses posting gains of over 1% and core European sovereign bond yields also rising across maturities. Investors see banking sector developments as likely to remain at the forefront with the latest headlines around US authorities considering an expansion of deposit insurance boosting sentiment and sending S&P 500 futures higher. The risk asset rally has also seen FOMC policy rate expectations shift slightly higher with futures now implying about a 75% probability of a 25 bp rate hike this week, but markets continue to price in more than 80 bps of rate cuts by the end of the year.

Key Global Financial Indicators

Last updated: 3/21/23 8:16 AM	Level		Change from Market Close					Since
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	23-Feb-22
Equities					%		%	
S&P 500		3952	0.9	2	-1	-11	3	-6
Eurostoxx 50		4193	1.8	0	-1	8	11	6
Nikkei 225		26946	-1.4	-3	-2	0	3	2
MSCI EM		38	0.4	0	-4	-15	0	-20
Yields and Spreads					bps			
US 10y Yield		3.56	7.5	-13	-39	127	-31	157
Germany 10y Yield		2.28	15.4	-14	-25	181	-29	205
EMBIG Sovereign Spread		508	-1	23	55	50	56	96
FX / Commodities / Volatility					%			
EM FX vs. USD, (+) = appreciation		50.0	0.5	-1	-1	-3	0	-6
Dollar index, (+) = $ appreciation		103.1	-0.2	-1	-1	5	0	7
Brent Crude Oil ($/barrel)		74.8	1.3	-3	-10	-35	-13	-23
VIX Index (%, change in pp)		22.8	-1.4	-1	0	-1	1	-8

Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

Mature Markets

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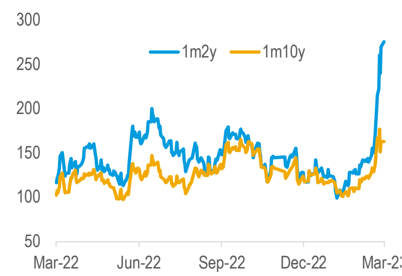
United States

Yesterday, the S&P 500 rose 0.9% and all eleven major sectors closed with gains. Bank stocks, as a whole, advanced while there was divergence among banks: First Republic shed by more than 40% while New York Community Bancorp jumped by 30% after taking over Signature Bank's deposits and some of its loans. Treasury yields went higher by 5–13 bps across tenors, with the curve flattening. Two-year yields increased 13 bps with continued large intra-day moves of 40 bps. Volatility continued to surge, especially in shorter tenors.

USD Swaption



Source:Bloomberg

US government bond funds experienced "flight to quality" inflows from investors amid intensifying concerns over banking sector risks. Overall, bond fund flows were flat, recording $0.1 bn of inflows last week, which was much lower than the prior four-week average inflows of $4.8 bn. However, there was also a noticeable rotation among funds as government funds saw strong inflows, while credit and mixed funds recorded substantial outflows. Not surprisingly, bank loan funds were hit hardest amid the banking sector turmoil.

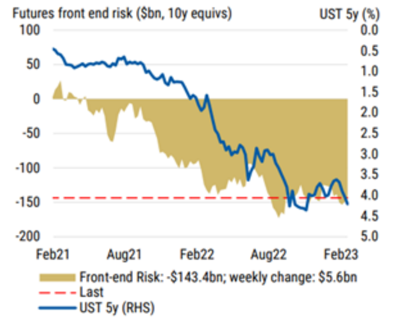
FIGURE 7. Five-day US bond fund flows as percentile of prior six-month range

5-day flow as percentile over prior 6m	latest flow vs history	3/16/2023	3/9/2023	3/2/2023	2/23/2023	2/16/2023	2/9/2023
All funds		47%	75%	94%	84%	68%	65%
Short Term Government		87%	56%	75%	98%	60%	20%
Intermediate Term Government		95%	11%	25%	6%	31%	72%
Long Term Government		100%	73%	55%	3%	92%	66%
Short Term Corporate		0%	22%	36%	57%	22%	52%
Intermediate Term Corporate		10%	39%	78%	37%	38%	35%
Long Term Corporate		77%	55%	82%	34%	8%	49%
Mortgage Backed		66%	85%	68%	71%	80%	81%
Municipal		52%	72%	41%	42%	68%	71%
Mixed Short Term		8%	54%	84%	92%	48%	30%
Mixed Intermediate Term		19%	65%	93%	91%	99%	87%
Mixed Long Term		46%	51%	8%	62%	93%	78%
Total Return		56%	65%	74%	80%	82%	95%
Inflation Protected		68%	85%	97%	45%	26%	40%
High Yield		31%	57%	37%	5%	5%	16%
Bank Loan		0%	74%	88%	32%	51%	78%

Source: EPFR, Barclays Research

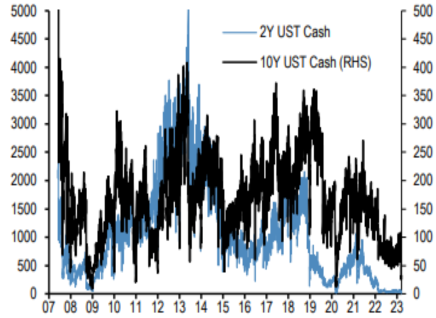
Recent sharp moves in Treasury markets may have been exacerbated by investors positioning and low liquidity conditions. Even after erasing some of the moves on Monday, US Treasury yields have dropped nearly 90 bp since the rise in financial stability concerns two weeks ago. CFTC non-commercial short positions in near-dated Treasury securities were at the highest level in recent years, and Morgan Stanley analysts see the short position as playing a key role in extending the decline in Treasury yields last week. In addition, market liquidity conditions have worsened as bid-ask spreads have widened and market depth, a liquidity measure based on the number of standing orders at the three best prices, has become shallower, and yield dispersion to a fitted curve increased. Total trading volumes have more than doubled over the past few days, pushing dealers' intermediation costs higher. While analysts largely agree that current low liquidity conditions reflect greater uncertainty over the FOMC policy path, they still see markets functioning and do not expect an immediate threat of market disruptions like what happened in March 2022.

Exhibit 25: Non-commercial positioning in front-end futures vs. 5-year yields



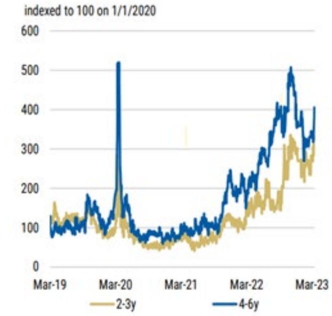
Source: Bloomberg, CFTC, Morgan Stanley Research

Figure 10: Market depth on 2y and 10y UST cash bonds



Source: J.P. Morgan.

Exhibit 29: Curve dispersion in the 2-3y sector and 4-6y sector in the last four years

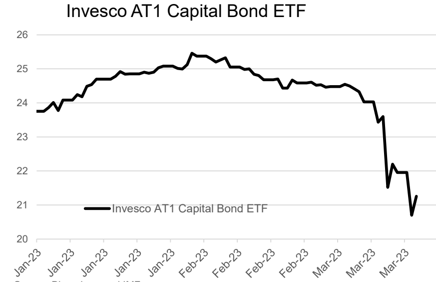


Source: Bloomberg, Morgan Stanley Research

Euro area

European markets are trading with a risk-on tone this morning. The Stoxx Europe 600 is now up 1.5%, and banking stocks are up sharply, gaining 3.9%. The euro is up 0.4% vs. the dollar, to 1.08/$. Bond yields are up, with German 10y bund yields up 13 bp to 2.25% and Italian spreads are down 5 bp to 182 bps even though the ZEW survey of expectations for Germany fell more than expected in March (to 13 vs. 15 expected from 28 in February). Markets have added 10 bp to their estimates of the ECB's terminal rate compared to yesterday, and it now stands at 3.2% by July.

Invesco AT1 Capital Bond ETF

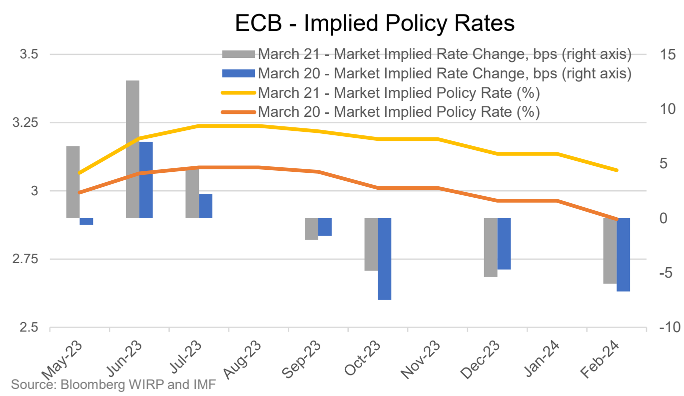


Source: Bloomberg and IMF

Losses on Credit Suisse AT1 bonds continue to be top of mind, even though some confidence seems to be returning to the AT1 bond market after the ECB and the BOE issued statements confirming that AT1 bonds are senior to equity in their jurisdictions. Bloomberg reports that the ECB is now asking banks about indirect exposure to Credit Suisse after having asserted that banks balance sheets show few holdings of Credit Suisse AT1 bonds. In UBS's purchase of credit Suisse over the weekend, about 16 billion Swiss francs of AT1 bonds ($17.2 billion) were written off. AT1 bonds (or Cocos) are perpetual bonds that banks use to augment their core equity base. They have loss-absorbing features and can be written off if a lender's capital falls below a certain threshold. They are in principle subordinate to all other debt and senior only to equity. Bloomberg also reports that Pimco and Invesco are among the largest investors in Credit Suisse's AT1 debt, owning about $807 million and $370 million of those bonds respectively.

In several speaking engagements yesterday ECB president Lagarde sought to further reassure markets about the strength of the eurozone banking sector and emphasized the importance of implementing Basel III recommendations. Speaking to the EU Parliament in Brussels, in her capacity as chair of the European Systemic Risk Board (ESRB), she said that from an ESRB perspective, she believes banks of all sizes should follow liquidity rules. This approach stands in contrast to the US, where only 14 US banks adhere fully to the so-called liquidity coverage ratio compared to 2,200 in the European Union. She also said that the exposure of euro-area banks to Credit Suisse is very limited, in the millions rather than in the billions. Lagarde's message was echoed by other ECB officials. Finnish governor Olli Rehn today also called for implementing Basel III regulations in European Union regulations, and for completing the banking union with a common deposit guarantee. ECB Governing Council member Ignazio Visco said at an event in Milan that regulators have the tools to deal with liquidity problems, but there are no issues currently.

ECB officials also expressed a variety of views about the ECB's monetary policy going forward, generally acknowledging that financial turmoil contributes to tighter monetary conditions. ECB president Lagarde reiterated that she does not see any conflict between price and financial stability. She added that financial stability tensions might have an impact on demand and might actually do part of the work that would otherwise be done by monetary policy, but that impact is uncertain at this point in time. Austrian governor Holzman said this morning that he is less certain than previously about whether three additional big (50 bp) interest-rate increases will be needed as turmoil in the banking system has decreased liquidity in the financial system, which may put downward pressure on inflation. Spanish governor de Cos refused to validate the market's expectations of a 3.25% terminal rate and emphasized that the ECB's future monetary policy decisions will be data dependent. Latvian governor Kazaks said that it is not possible to say that the ECB has stopped raising rates at this point as inflation is still very high. In contrast, his Greek colleague Yannis Stournaras warned on CNBC Europe that the ECB is now "close to the end of the tightening cycle" and that "rate hikes are mostly now a story of the past.



United Kingdom

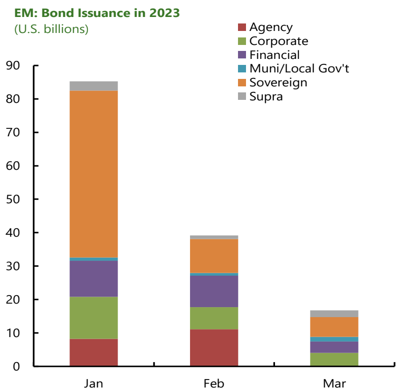
In the UK, equity markets (FTSE 100) are decisively up, gaining 1.5%. The British pound is weakening against the dollar (-0.2% to 1.23 £/$). Yields on 10y gilts are up 5 bp to 3.36%. The markets are expecting inflation for February tomorrow (9.9% y/y expected, down from 10.1% in January, core inflation expected at 5.7% y/y down from 5.8% in January), ahead of the Bank of England rate decision on Thursday (markets are pricing in 12 bp in hikes). Yesterday afternoon, the BoE published a statement saying that AT1 instruments rank ahead of CET1 and behind T2 in its hierarchy, and holders of such instruments should expect to be exposed to losses in resolution or insolvency in the order of their positions in the hierarchy. The statement also points out that this was the approach used for the recent resolution of SVB UK.

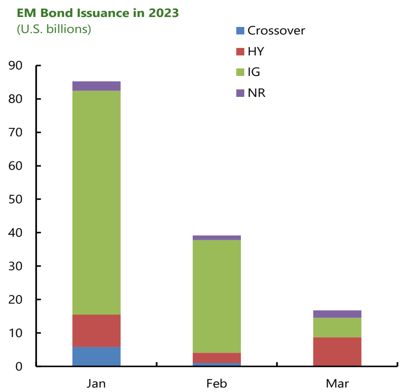
Emerging Markets back to top

Major Latin American currencies appreciated against the U.S. dollar while sovereign CDS spreads widened across the region. Chile's finance minister, Mario Marcel, stated that he does not fear contagion effects from Credit Suisse since their financial system "remains as solid as ever." **Asian stocks recovered +0.9%.** Additional Tier 1 bonds issued by banks in Asia Pacific rebounded, with shares also rising**.** The 10-day volatility measure on the region's financial stocks hit its highest since March 2022, Bloomberg estimated. Hong Kong SAR was up +1.4%, Singapore gained +1.1%. **Asian currencies were mixed.** Philippine peso appreciated +0.5%, Thai baht weakened -0.4%. **Thailand** will hold a general election on May 14 to vote in new lawmakers for the 500-member House of Representatives**. Equities in EMEA were mostly trading higher while currencies were mixed.** Equities in Egypt (+3.1%) and South Africa (+2.4%) are outperforming while Turkish stocks (-1.2%) underperformed. The Hungarian forint outperformed regional peers, strengthening +1.5% against the euro, while the South African rand depreciated (-0.4%) against the dollar.

Emerging Market Bond Issuance

Emerging market bond issuance has been lower in March so far compared to February, while bond issuance for last week was $905 million. Year-to-date issuance is $141 bn, up 13% compared to a year ago. Sovereigns have accounted for 47% of total issuance, followed by financials (17%), and corporates (16%). The top five issuers by country have been Saudi Arabia, China, Korea, Hong Kong, and Mexico, in total accounting for 45% of total issuance year-to-date. Non-investment grade issuance declined by 64% year-to-date compared to a year ago.

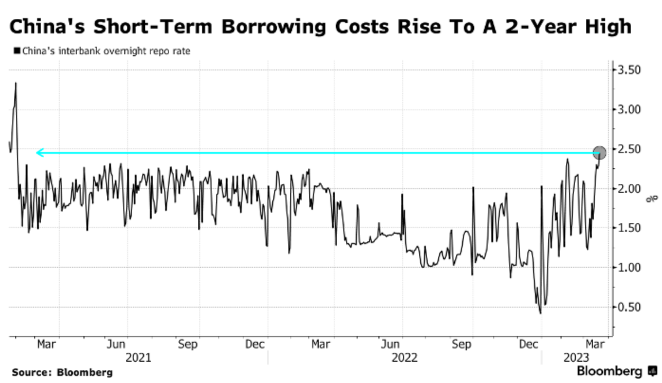




Sources: Bondradar and staff estimates.

China / Hong Kong SAR

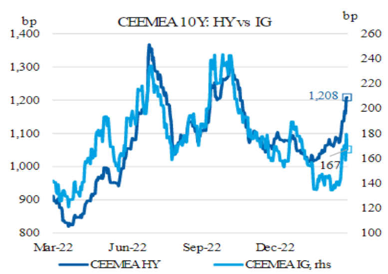
China's Ministry of Finance (MOF) has started a campaign to scrutinize accounting standards to reduce risks and promote "high-quality" economic development. China launched the initiative in the aftermath of a record fine and closure of a Deloitte' office in Beijing last week due to allegations of lapses in its auditing work for Huarong, Bloomberg noted. Separately, **interbank funding costs surged in Mainland China and Hong Kong SAR**. Hong Kong SAR's Hibor was up 253 bp to 4.14% on Tuesday, the biggest jump since at least 2006. China's overnight repo rate rose 17 bp to 2.45%, the highest level since February 2021. However, the seven-day renminbi rate remained near 2.22%, signaling that traders expect liquidity conditions to improve when lower reserve requirement cash comes into effect on March 27. Some analysts noted the increase in Hibor could have been driven by concerns about the banking sector and speculation about related equity outflow. Also, short-term liquidity is becoming scarcer as lenders are setting cash aside for quarter-end regulatory checks and are disbursing more loans amid a recovery fueled by a reopening of the economy, Bloomberg reported. Separately, Sino-Ocean's dollar bonds slumped as the developer elected to defer a perpetual note's interest payment. Earlier this month, Moody's downgraded Sino-Ocean's ratings to Ba3 with a negative outlook. **Chinese equities gained (Shanghai +0.6%, Shenzhen +1.6%, Hang Seng China Enterprises +1.2%). Renminbi and 10Y bond yields were little changed.**



CEEMEA

CEEMEA funding needs remain under pressure amid broader financial risk stability, US banking liquidity concerns and sticky US inflation data. Morgan Stanley analysts highlight that absolute credit spreads are higher than at the start of the year, which could bring into question how countries in the region would fulfill their funding needs. Nevertheless, given what has already been issued and with investors still sitting on remarkably high cash balances, analysts see increased capacity to absorb further issuance once macro risks ease. As such, Morgan Stanley analysts still see their overall 2023 target for sovereign issuance of $143 bn as valid. However, analysts also highlight almost 40% of CEEMEA credits are currently without market access. Last week CEEMEA HY spreads ended the week 72 bp wider, while CEEMEA IG credit spreads ended the week little changed after earlier weakness was retraced.

Exhibit 1: IG has recouped its weekly losses but remains wide year to date



Source: Bloomberg, Morgan Stanley Research

Exhibit 2: EMBI has surged past 500bp for the first time since October 2022

Source: Bloomberg, Morgan Stanley Research

Africa

The average risk premium for African bonds over US Treasuries increased past 1000 bp as investors scale back risk appetite amid concerns over the global financial system. Bloomberg reports that with African sovereign spreads increasing for 10 consecutive days, this is the longest streak of increases since January 2016. The risk premium on African sovereign bonds has increased from roughly 800 bps at the start of March to over 1000 bps yesterday—a level that many investors see as distressed—with spreads in Kenya, Namibia and Zambia reportedly seeing the largest increases.

This monitor is prepared under the guidance of Charles Cohen (Acting Division Chief), Nassira Abbas (Deputy Division Chief), and Antonio Garcia-Pascual (Deputy Division Chief). Fabio Cortes (Senior Economist), Reinout De Bock (Senior Economist-London Representative), Sanjay Hazarika (Senior Financial Sector Expert), Esti Kemp (Financial Sector Expert-London Representative), Johannes S Kramer (New York Representative), Aurelie Martin (Senior Economist-London Representative), Tom Piontek (Senior Financial Sector Expert) and Jeff Williams (Senior Financial Sector Expert) are the lead editors of this monitor. The contributors are Yingyuan Chen (Financial Sector Expert), Deepali Gautam (Research Officer), Shoko Ikarashi (Externally Financed Appointee), Phakawa Jeasakul (IMF Resident Representative in Hong Kong SAR), Harrison Kraus (Research Assistant), Yiran Li (Research Assistant), Kleopatra Nikolaou (Senior Financial Sector Expert), Natalia Novikova (IMF Resident Representative in Singapore), Mustafa Oguz Caylan (Research Officer), Silvia Ramirez (Senior Financial Sector Expert), Patrick Schneider (Financial Sector Expert), Ying Xu (Economist), Dmitry Yakovlev (Senior Research Officer), and Akihiko Yokoyama (Senior Financial Sector Expert). Javier Chang (Senior Administrative Assistant) Olga Lefebvre (Staff Assistant), and Srujana Sammeta (Staff Assistant) are responsible for the word processing and production of this monitor.

Global Financial Indicators

Last updated: 3/21/23 8:17 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD	Since 23-Feb-22
Equities					%		%	%
United States		3957	0.9	1	-1	-11	3	-6
Europe		4193	1.8	0	-1	8	11	6
Japan		26946	-1.4	-3	-2	0	3	2
China		3982	1.1	0	-3	-6	3	-14
Asia Ex Japan		65	0.2	0	-3	-13	0	-18
Emerging Markets		38	0.4	0	-4	-15	0	-20
Interest Rates					basis points			
US 10y Yield		3.56	7.5	-13	-39	127	-31	157
Germany 10y Yield		2.28	15.4	-14	-25	181	-29	205
Japan 10y Yield		0.25	0.0	-2	-26	4	-17	5
UK 10y Yield		3.39	7.9	-10	-23	175	-28	191
Credit Spreads					basis points			
US Investment Grade		175	-4.9	7	29	31	16	32
US High Yield		521	-15.5	29	54	128	41	115
Europe IG		92	-6.4	2	10	12	1	20
Europe HY		474	-26.5	16	49	99	0	122
Exchange Rates					%			
USD/Majors		103.07	-0.2	-1	-1	5	0	7
EUR/USD		1.08	0.6	0	1	-2	1	-5
USD/JPY		132.4	0.8	-1	-2	11	1	15
EM/USD		50.0	0.5	-1	-1	-3	0	-6
Commodities					%			
Brent Crude Oil ($/barrel)		74.8	1.3	-3	-10	-19	-12	-11
Industrials Metals (index)		155	0.7	-1	-8	-26	-6	-17
Agriculture (index)		68	0.9	1	-4	-10	-2	-4
Implied Volatility					%			
VIX Index (%, change in pp)		22.8	-1.4	-1.0	-0.1	-0.8	1.1	-8.3
US 10y Swaption Volatility		151.2	-11.3	-8.9	31.6	48.7	25.5	56.9
Global FX Volatility		11.1	0.0	0.3	0.9	2.3	0.4	3.6
EA Sovereign Spreads					10-Year spread vs. Germany (bps)			
Greece		192	-5.8	1	2	-30	-13	-48
Italy		183	-3.1	-1	-10	29	-31	12
Portugal		85	-4.1	-5	-5	5	-17	-7
Spain		104	-2.9	-2	5	10	-5	1

Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

Emerging Market Financial Indicators

Last updated: 3/21/2023 8:18 AM	Exchange Rates							Local Currency Bond Yields (GBI EM)						
	Level		Change (in %)					Level		Change (in basis points)				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.					
China		6.87	0.1	0.0	0	-8	0		3.1	9.5	-1	-10	27	7
Indonesia		15345	0.1	0.3	-1	-7	1		6.9	-0.6	17	15	19	-4
India		83	0.0	-0.2	0	-8	0		7.5	10.4	-3	-13	36	4
Philippines		54	0.4	1.2	1	-4	2		6.0	-2.5	-3	0	90	-5
Thailand		34	-0.6	0.6	1	-2	1		2.4	2.0	-8	-31	4	-24
Malaysia		4.47	0.4	0.4	-1	-6	-1		3.9	2.7	8	7	25	-10
Argentina		205	-0.6	-1.6	-6	-46	-13		90.5	-36.4	121	270	4151	234
Brazil		5.23	0.2	0.5	-1	-6	1		14.3	106.4	103	97	207	171
Chile		819	0.7	-2.2	-2	-3	4		5.1	9.0	-19	-58	-96	-27
Colombia		4827	1.0	-2.4	2	-21	1		9.1	0.0	-34	-108	130	-71
Mexico		18.70	0.8	-0.5	-1	9	4		8.6	-3.9	-12	-28	23	-16
Peru		3.8	0.4	0.5	2	0	1		7.6	-0.2	-24	-32	108	-32
Uruguay		39	0.6	0.4	0	9	2		10.4	-0.1	3	56	196	-33
Hungary		363	1.5	0.0	-1	-7	3		8.5	7.0	12	-33	267	-113
Poland		4.36	0.7	0.5	2	-2	0		5.4	7.0	-3	-66	71	-80
Romania		4.6	0.6	0.4	1	-2	1		7.3	1.5	12	-15	157	-44
Russia		76.9	-0.2	-1.5	-3	39	-4							
South Africa		18.6	-0.5	-2.6	-2	-20	-8		8.9	0.5	-26	-36	89	-23
Turkey		19.03	-0.1	-0.3	-1	-22	-2		11.6	-25.0	32	108	-1504	174
US (DXY; 5y UST)		103	-0.2	-0.5	-1	5	0		3.71	11.9	-14	-47	139	-30

	Equity Markets							Bond Spreads on USD Debt (EMBIG)					
	Level		Change (in %)					Level		Change (in basis points)			
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	7 Days	30 Days	12 M	YTD
								basis points					
China		3982	1.1	0	-3	-6	3		181	8	11	-44	4
Indonesia		6692	1.2	1	-2	-4	-2		164	-4	8	-28	24
India		58075	0.8	0	-3	0	-5		182	20	35	13	40
Philippines		6531	1.2	2	-3	-7	-1		140	5	5	3	43
Thailand		1577	1.4	3	-5	-6	-5						
Malaysia		1407	0.3	1	-4	-11	-6		108	10	8	-27	8
Argentina		221059	-0.3	-2	-11	146	9		2381	50	245	590	176
Brazil		100923	-1.0	-2	-8	-13	-8		289	0	20	-19	15
Chile		5170	1.1	-2	-2	4	-2		152	-4	16	-8	20
Colombia		1110	-0.7	-4	-8	-28	-14		443	11	27	105	71
Mexico		51926	-1.1	-2	-4	-6	7		424	20	60	73	43
Peru		21435	0.0	-1	-2	-16	0		194	-2	11	21	14
Hungary		42176	2.0	1	-6	-5	-4		254	18	35	102	32
Poland		57403	1.7	-2	-4	-10	0		100	-1	23	50	27
Romania		12111	0.5	-3	-2	-5	4		279	25	29	63	23
South Africa		74271	0.0	-2	-6	-1	2		425	29	45	56	58
Turkey		4908	-1.3	-6	-5	126	-11		481	-7	-45	-97	41
Ukraine		507	0.0	0	0	-2	-2		4948	126	434	1700	869
EM total		38	0.9	0	-4	-15	0		428	13	35	-111	53

Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

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